

UNITED STATES OF AMERICA
DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
OFFICE OF ADMINISTRATIVE LAW JUDGES

In The Matter of:

A. JAMES LYNN,

Respondent.

HUDALJ 96-0038-DB

A. James Lynn, *pro se*

Luke H. Brown, Esquire
For the Government

Before: THOMAS C. HEINZ
Administrative Law Judge

HEARING OFFICER'S FINDINGS OF FACT

Statement of the Case

This proceeding arose pursuant to 24 C.F.R. § 24.100 *et seq.* as a result of action taken by the Inspector General of the Department of Housing and Urban Development ("HUD" or "the Government") acting in her capacity as a debarring official under the regulations. On January 11, 1996, the Inspector General proposed to debar A. James Lynn ("Respondent") from future participation in procurement and non-procurement transactions as either a participant or a principal with HUD and throughout the Executive Branch of the Federal Government for a two-year period.

Although the debarring official in her letter of January 11, 1996, designated an official within the Office of Inspector General to conduct an informal hearing if requested, and Respondent requested a hearing on February 7, 1996, an informal hearing was not held. Instead, the matter was referred on June 6, 1996, by the HUD official designated to conduct an informal hearing to the Office of Administrative Law Judges ("OALJ") for a hearing and preparation of findings of fact regarding the eight issues listed below.

Pursuant to an Order requiring the parties to file prehearing statements, the

Government filed a statement on July 29, 1996, which, *inter alia*, significantly modified the eight issues listed in the referral of June 6, 1996, and added four more to the list.¹ The parties were permitted to submit evidence into the record regarding some of these additional issues as well as other issues in order to create a more complete record for review by the debarring official, but I make no findings concerning any issue other than the eight issues specified in the referral because my mandate is circumscribed by the referral. Further, although 24 C.F.R. § 24.314(b)(2)(i) authorizes the debarring official to request that the hearing officer prepare both findings of fact and conclusions of law, the referral requested the OALJ to prepare only findings of fact. In other words, the referral did not request a *de novo* review of the administrative action. *Cf.* 24 C.F.R. § 26.24. Accordingly, I reach no independent conclusions as to whether Respondent's conduct as demonstrated in the record complied with duties imposed by law, or whether Respondent should be debarred.

By mutual agreement of the parties, an oral hearing was held in Fort Worth, Texas, on August 6 and 7, 1996. At the close of the hearing, the parties were directed to file briefs. The last brief was received on September 24, 1996.

Findings of Fact

Issue Number 1. Whether the Respondent individually or as an employee of Lynn, Nolan, & Co., PC, provided audit services and bookkeeping services to the same client.

¹For example, Issue number 2 in the referral reads: "Whether the Respondent prepared audit plans for two of the three annual financial statement audits." In its prehearing statement, the Government altered the issue to read: "Whether Respondent as president, majority shareholder, managing partner, individually or as an employee of Lynn/Nolan, prepared adequate or legitimate audit plans for Cottonwood Park, and Georgetown I Associates Limited Partnership ("Georgetown")."

1. Respondent is a Certified Public Accountant ("CPA"). (Tr. 36, 328).² He was the incorporator, the sole director, majority shareholder, and president of Lynn, McEvoy, Nolan, PC, an accounting firm located in Dallas, Texas. (Tr. 247; Gx. 31-33; Stip. 7) When the Firm was first formed in 1990 Respondent owned 60 percent of the stock. Sometime after November 1991, Mr. McEvoy left the firm, Respondent's ownership interest increased, and the firm name changed to "Lynn, Nolan, & Co., PC," ("the Firm") (Tr. 247, 248, 299; Gx. 32)

2. The American Institute of Certified Public Accountants ("AICPA") has issued auditing standards with which every CPA, including Respondent, is required to comply. (Tr. 38-39; Gx.1; Stip. 2)

3. The U.S. General Accounting Office has issued Government Auditing Standards ("GAS") with which CPAs and auditors doing business with the government must comply. (Tr. 40; Gx. 2) As an auditor performing work on HUD properties, Respondent was bound by GAS. (Tr. 40; Gx. 2; Stip. 1)

4. Respondent managed and controlled the day-to-day operations of the Firm. (Tr. 251, 255, 301, 371) He supervised the audits and bookkeeping services performed by the Firm, and was principally responsible for planning audits. (Tr. 223-225, 245, 255-56, 293, 301-02, 304, 305, 348-49)

5. Cottonwood Park Village, Ltd. ("Cottonwood"), Georgetown I Associates Limited Partnership ("Georgetown"), and Wheatland Terrace Apartments, Ltd. ("Wheatland") are multi-family residential projects with HUD-insured mortgages. Warren Gilbert, Jr., was one of the owners of these three projects. (Gx. 9, 14, 17, 24, 25)

6. Eastfield Management Company ("Eastfield") was the management agent for Cottonwood, Georgetown, and Wheatland during 1991. (Tr. 49) Eastfield was controlled by Warren Gilbert, Jr. (Tr. 7, 87, 90)

7. The Firm provided bookkeeping services for Eastfield during 1991. (Tr. 48-49, 255, 304)

²The following abbreviations are used in these findings: "Tr." refers to the hearing transcript; "Gx." and "Rx." refer, respectively, to the Government's and the Respondent's exhibits, and "Stip." refers to the stipulations entered into by the parties.

8. The Firm provided bookkeeping services for Cottonwood, Georgetown, and Wheatland during 1991, and audited the 1991 operations of all three projects as well. (Tr. 224-25, 255, 329, 336-37; Gx. 9, 24, 25; Stip. 4)

9. Respondent as an individual worked on the audits of Georgetown and Wheatland. (Stip. 5, 6)

10. Respondent as an individual did not provide both audit and bookkeeping services to Cottonwood, Georgetown, or Wheatland in 1991. (Tr. 329).

11. The Government did not argue on brief that Respondent as an employee of the Firm provided both audit and bookkeeping services to the same client.

Issue Number 2. Whether the Respondent prepared audit plans for two of the three annual financial statement audits.

This issue must be considered abandoned by the Government because the Government's post-hearing brief did nothing more than recite an altered version of the issue in a list of eight issues raised by the case. The brief did not contain an argument with citations to the record concerning this issue.

Issue Number 3. Whether the Respondent failed to test or demonstrate sufficient understanding of internal controls.

1. "Internal controls" are accounting and other safeguards designed to prevent economic waste, fraud, and abuse in a company. (Tr. 100-01)

2. An auditor must review and evaluate whatever internal controls are in place at the beginning of an audit. The result of this evaluation forms the basis for the creation of an audit plan of the company's operations. (Tr. 101) Without gaining an understanding of internal controls, an auditor cannot make an adequate determination of what tests need to be done during the audit. (Tr. 103)

3. Respondent's firm uses audit planning forms for audits of properties with mortgages insured by HUD that include the following injunction: "This form should be completed or updated in the planning stage of each audit." (Gx. 16, 17) Completing an audit planning form is part of an auditor's review of internal controls. (Tr. 112-13) The last page of the form contains places for the reviewer to indicate the date of the review, the year reviewed, and the initials of the reviewer. (Gx. 16, 17) In other words, the form demonstrates that it was designed for use in multiple years.

4. Respondent conceded that members of his firm did not always initial and date the last page of the form, but he claimed that the last page of the form was dated and initialed only in those years when changes had been made from the previous year. (Tr. 348-49) This explanation cannot be credited. The record contains two forms that have been initialed and dated even though the forms do not demonstrate any changes in the internal controls or audit plans from the previous years. (Gx. 16-17)

5. The Government argues that Respondent performed audit testing before reviewing internal controls, the reverse of the required order. This argument cannot be credited because it relies in part on an exhibit that was identified but not introduced into evidence at hearing (Gx. 18), and because the exhibit is incomplete and conflicts with testimony of the sponsoring witness regarding the date of its execution. The exhibit is

dated February 1, 1992, but the witness testified that the document upon which the Government's argument relies was executed on February 2, 1992. (Tr. 110-11, 112)

6. The Government has failed to demonstrate the meaning of the phrase "test . . . internal controls" as found in Issue Number 3. I therefore am unable to make a finding in that regard.

7. The record does not show that "Respondent failed to demonstrate sufficient understanding of internal controls." At best, the evidence shows that Respondent's firm failed consistently to *document* that reviews of internal controls were completed at the appropriate time.

Issue Number 4. Whether the Respondent failed to adequately supervise his employees.

This issue must be considered abandoned by the Government because the Government's post-hearing brief did nothing more than recite an altered version of the issue in a list of eight issues raised by the case. The brief did not contain an argument with citations to the record concerning this issue.

Issue Number 5. Whether the Respondent examined sufficient competent evidential matter in income statements.

1. Respondent's firm analyzed expenses incurred in 1991 by Georgetown, Wheatland, and Cottonwood and discovered significant fluctuations in some expense accounts compared to expenses incurred in the previous year. (Gx. 20, 26, 27) For example, the Janitors' Salaries account at Georgetown increased from \$14,430 in 1990 to \$40,326 in 1991, a difference of 179.46%. Similarly, the Repairs Material account at

Georgetown increased without explanation by 194.78% from \$18,793 in 1990 to \$55,399 in 1991. (Gx. 20, 22)

2. An auditor should determine from management why significant fluctuations occur in accounts from year to year. (Tr. 118)

3. An auditor from Respondent's firm requested the owner of Georgetown to explain some of the fluctuations, but apparently received no response and did not follow-up on the request. (Tr. 119; Gx. 22)

4. HUD's auditor found no evidence in the Firm's records that similar inquiries had been made regarding fluctuations in expense accounts for Wheatland and Cottonwood in 1991. (Tr. 119)

5. The Firm's audit workpapers for Wheatland and Cottonwood revealed numerous instances where the Firm's auditors found expenditures unsupported by source documents. (Gx. 28, 29) However, each of the unsupported expenditures was less than \$1,000.

6. Citing AICPA Professional Standards §§ 316.05 and 316.3(*sic*), Respondent argues in his brief that it is up to the individual auditor to decide in his professional judgment whether a fluctuation or an unsupported expenditure is sufficiently material to merit further inquiry. (Brief, p. 24; Gx. 1; Tr. 352-55) Section 316.34 states in part that in "planning the audit, the auditor is concerned with matters that could be material to the financial statements." Section 316.05 provides that:

The auditor should assess the risk that errors and irregularities may cause the financial statements to contain a material misstatement. Based on that assessment, the auditor should design the audit to provide reasonable assurance of detecting errors and irregularities that are material to the financial statements. [Gx. 1]

7. Although AICPA Standards permit auditors to decide what is material, this fact does not justify the failure by the auditor of Georgetown's operations to follow up on his request for explanation of fluctuations which he had identified as material.

8. Concerning expense account fluctuations, the record shows that an auditor in Respondent's firm failed to examine sufficient competent evidential matter in income statements. (Tr. 118-19; Gx. 20, 22, 26, 27)

9. Concerning expenditures unsupported by source documents, the record does not

show that Respondent or any member of his firm failed to examine sufficient competent evidential matter in income statements.³

Issue Number 6. Whether the Respondent designed his audits to detect errors and irregularities.

This issue must be considered abandoned by the Government because the Government's post-hearing brief did nothing more than recite an altered version of the issue in a list of eight issues raised by the case. The brief did not contain an argument with citations to the record concerning this issue.

Issue Number 7. Whether the Respondent characterized an owner advance as a third-party loan.

1. During the last part of 1990, the partnership owners of the Georgetown project injected an additional \$50,000 into the project beyond their previous contributions. This transaction was originally recorded in Georgetown records as an amount payable to the partners, that is, an advance or loan. (Gx. 6; Tr. 63-64)

2. The records of Respondent's firm include a memorandum dated January 21, 1991, from Respondent to "Georgetown #1 Permanent Audit File, Georgetown #2 Permanent Audit File, and Warren A. Gilbert, Jr. (Gx. 6) That memorandum shows that Respondent and the owners of Georgetown agreed to alter Georgetown accounts and prepare non-interest bearing notes to make it appear that the \$50,000 came not from the owners but from the company managing the project. The purpose of these actions was "to prevent HUD scrutiny of the transaction which might result in a finding that the contributions were made by partners, requiring HUD consent for repayment." (Gx. 6) If the advance were characterized as coming from the owners rather than from the

³The Government argues that the Firm's workpapers failed to contain sufficient information to obviate oral explanation, in violation of GAS, Chapter 4, 22(c). The argument may be well-founded, but the debarring official did not charge Respondent with that violation as a ground for debarment.

management agent, and the project defaulted, it would be difficult for the owners to get their money back. (Tr. 65)

3. Respondent's firm issued an audit of Georgetown's 1991 operations on February 6, 1992. That audit indicated that the project was in default on its mortgage and that the alterations to Georgetown records had been made as described in the memorandum of January 21, 1991. (Gx. 9, p. 8)⁴

4. Respondent argues that Gx. 6 was merely the rough draft of the memorandum, and that the final memorandum (Rx. 9) shows that "the concern over HUD scrutiny is not over who advanced the funds, as the Government would want this court to believe, but rather whether the obligation should bear interest." (Respondent's Brief, p. 26.) This argument is unpersuasive. Read together, the two memoranda show a clear intention to mask a capital contribution to the project so as to increase the probability that the contributors would recoup their investment.

5. Respondent characterized an owner advance as a third-party loan. (Tr. 63-64, 65; Gx. 6, 9; Rx. 9)

Issue Number 8. Whether the Respondent falsely reported that \$127,000 was expended to pay an insurance premium.

1. As noted above, Eastfield was the management agent for Cottonwood, Georgetown, and Wheatland. Eastfield used its payroll account to pay workmen's compensation premiums each month for employees of the projects. The projects then reimbursed Eastfield's payroll account for the amount of the premiums. (Tr. 86-88)

2. During the last three months of 1991, Eastfield did not pay workmen's compensation premiums for employees of the projects as a result of a dispute with the

⁴The Government argues that the \$50,000 note was not actually executed despite representation to the contrary in the Georgetown audit. However, the debarring official did not charge Respondent with falsely reporting that the note had been executed.

insurer, Hartford Insurance Company. (Tr. 88) However, during those three months the projects continued to pay Eastfield their monthly shares of workmen's compensation premiums. The sum of the premiums transferred to Eastfield by the projects during this period was \$17,669. (Gx. 9, 24, 25)

3. Respondent recognized during his firm's audit of the 1991 operations of the properties that by withholding payment of workmen's compensation premiums and receiving reimbursement from the projects, Eastfield had received an advance of funds. Respondent acknowledged that there was HUD money (that is, project money) in the Eastfield payroll account (Tr. 89, 371; Gx. 12) Respondent did not disclose this information to HUD or in his firm's audits of the projects' 1991 operations. (Gx. 9, 12, 24, 25)

4. Respondent's firm prepared reports of financial statements and supplemental schedules covering the 1991 operations of Georgetown, Cottonwood, and Wheatland. (Gx. 9, 24, 25) These reports show payment in 1991 of \$17,669 in workmen's compensation premiums for employees of the projects which Respondent knew had not, in fact, been paid to the insurer. (Gx. 12)

5. Respondent did not falsely report that \$127,000 was expended to pay an insurance premium.

Additional Findings of Fact

1. On October 6, 1995, Respondent entered into an Agreed Consent Order with the Texas State Board of Public Accountancy. The Agreed Consent Order was based on the following findings of fact:

A. A. James Lynn, Respondent, holds Certificate Number 015744 as a Certified Public Accountant in the State of Texas.

B. The Board notified Respondent that an investigation had been initiated based upon a complaint from the U.S. Department of Housing and Urban Development ("HUD").

C. Respondent failed to meet governmental auditing standards in his audited financial statements for a HUD supervised project. [Gx. 35]

2. The Board concluded as a matter of law that Respondent's conduct violated various sections of the Board's Rules of Professional Conduct as well as § 21(c)(4) of the Public Accountancy Act of 1991, as amended. (Gx. 35)

3. The Board reprimanded Respondent for failing to meet governmental auditing standards and limited the scope of his practice by prohibiting him from performing audits and reviews for the period of one year. The Consent Order was issued on October 19, 1995. (Gx. 35)

4. Counsel for the Government asserted that the Board reviewed the same evidence as was presented by the Government in this case. (Tr. 413) Respondent agreed with that assertion but contended that the Board reviewed some additional evidence. (Tr. 375-80)⁵

The above findings of fact are based on a preponderance of the evidence in the record.

THOMAS C. HEINZ
Administrative Law Judge

Dated: October 23, 1996

⁵In his answer of April 24, 1996, to the letter of January 11, 1996, proposing debarment, Respondent posed several affirmative defenses, including an allegation that HUD employees misrepresented the facts before the Accountancy Board. I make no findings regarding this or any other affirmative defense because the issues raised by Respondent's affirmative defenses were not listed in the referral of June 6, 1996.

CERTIFICATION OF SERVICE

I hereby certify that copies of this HEARING OFFICER'S FINDINGS OF FACT issued by THOMAS C. HEINZ, Administrative Law Judge, in HUDALJ 96-0038-DB, were sent to the following parties on this 23rd day of October, 1996, in the manner indicated:

Chief Docket Clerk

REGULAR MAIL:

A. James Lynn
6820 Walling Lane
Dallas, TX 75231

INTER OFFICE MESSENGER:

James A. Heist, Director
Financial Audits Division
U.S. Department of Housing and Urban Development
451 7th Street, S.W., #8282
Washington, D.C. 20410

Luke H. Brown, Esquire
U.S. Department of Housing and Urban Development
451 7th Street, S.W., #10251
Washington, D.C. 20410

Nilda Gallegos, Docket Clerk
for Debarments and Suspensions
U.S. Department of Housing and Urban Development
451 7th Street, S.W., #10251
Washington, D.C. 20410